Nebraska Law Review

Volume 43 | Issue 1 Article 8

1963

# Real Estate Valuation in Condemnation Cases—The Place for the Expert

Richard P. Nelson
*University of Nebraska College of Law*, rnels@eslaw.com

# REAL ESTATE VALUATION IN CONDEMNATION CASES—THE PLACE FOR THE EXPERT

Every person whose land is taken for public use by eminent domain proceedings is constitutionally entitled to receive just compensation,[1] which has been defined by all courts as fair market value.[2] The history of condemnation proceedings is the history of the courts' struggle to devise methods of determining the fair market value of land. The scope of this article is limited to the importance of land value experts in determining fair market value. The rules of admissibility of evidence in the Nebraska courts are at variance with the actual procedures employed by real estate experts. The purpose of this article is to compare business methods of land valuation with court methods in condemnation proceedings, and to suggest modifications in evidentiary rules that will permit the best use of expert testimony and achieve an equitable result for both the condemnor and condemnee.

## JUDICIAL TREATMENT OF THE EXPERT

The early American courts accepted the English view on admissibility of opinion evidence by experts which required the witness to be skilled and to state the facts on which he based his opinion.[3] Despite this general acceptance the New York court, in particular, looked unfavorably upon testimony given by real estate experts.[4] Nebraska, in a case of first impression, refused to allow statements of opinion on value,[5] but this position was soon expressly overruled.[6] The federal courts also distrusted expert opinion of value unless the facts upon which the opinion rested were fully disclosed.[7] An often voiced criticism is clearly presented in *Roberts v. New York Elec. Ry.*:[8]

> Expert evidence, so-called, or in other words, evidence of the

---

[1] NEB. CONST., art. 1, § 21; U.S. CONST., amend. V.

[2] 5 NICHOLS, EMINENT DOMAIN § 12.2 (3d ed. 1962).

[3] Forbes v. Caruthers, 3 Yeates 527 (Pa. 1803); Harrison v. Rowan, 3 Wash. 580 (C.C. N.J. 1820).

[4] Roberts v. New York Elevated R. R., 128 N.Y. 455, 28 N.E. 486 (1891); Ferguson v. Hubbell, 97 N.Y. 507, 49 Am. Rep. 544 (1884); *In re* Board of Water Supply, 170 App. Div. 107, 155 N.Y. Supp. 753 (3d Dep't 1915).

[5] Fremont E. & M.V. R.R. v. Whalen, 11 Neb. 585, 10 N.W. 491 (1881).

[6] Republican Valley R.R. v. Arnold, 13 Neb. 485, 14 N.W. 478 (1882).

[7] *E.g.*, Welch v. TVA, 108 F.2d 95 (6th Cir. 1939).

[8] 128 N.Y. 455, 464-65, 28 N.E. 486, 487 (1891).

> mere opinion of witnesses, has been used to such an extent that the evidence given by them has come to be looked upon with great suspicion by both courts and juries, and the fact has become very plain that in any case where opinion evidence is admissible, the particular kind of an opinion desired by any party to the investigation can be readily procured by paying the market price therefor.

The immediately apparent answer to such an indictment is that "the employment of real estate experts in land damage cases, if an evil, is undoubtedly a necessary one."[9] The wide discrepancy in valuation figures given by different experts on the same land may often be explained by considering first that such opinion is necessarily based on many variables, and secondly, by realizing that experts with an optimistic viewpoint tend to testify for condemnees, while those with a more conservative outlook support the condemnors. Even though such discrepancies exist, it is far better to allow men with skill and training in the area to state their opinions than it is to allow an uninformed guess which "is simply a shot in the dark—nothing more."[10]

All courts now allow real estate experts to state their opinions, whether the court is favorable to expert value testimony or not. The weight of the opinion depends on how well it is supported by facts which the expert gives.[11] Detailing such information is a safeguard against the bias of the witness, and it is an intelligent means of allowing the jury to decide the accuracy of the opinion.[12] The more relevant detail the witness is allowed to give, the better the likelihood of a fair and impartial valuation.

## THE REAL ESTATE APPRAISAL PROCESS

"Real estate appraising is a service function, often designated as a profession. This service can be accomplished only through adherence to basic principles, techniques . . . acceptable to and understood by appraisers and by the public."[13] At least, appraising

---

[9] 5 NICHOLS, EMINENT DOMAIN § 18.41 (3d ed. 1962).

[10] *Ibid.*

[11] *E.g.*, Washington v. United States, 214 F.2d 33 (9th Cir. 1954); Webber v. City of Scottsbluff, 150 Neb. 446, 35 N.W.2d 110 (1948); City of Denver v. Quick, 108 Colo. 111, 113 P.2d 999 (1941). *Cf.* Viliborghi v. Prescott School Dist. No. 1, 55 Ariz. 230, 100 P.2d 178 (1940) (where detail information was allowed only on cross-examination).

[12] State v. Peterson, 12 Utah 2d 317, 320, 366 P.2d 76, 78 (1961): "[If the information were distorted], the frailty would be subject to exposure on cross-examination. . . . It is thus of importance to the court and jury to know what it was based upon . . . ."

[13] FRIEDMAN, ENCYCLOPEDIA OF REAL ESTATE APPRAISING 17 (1959).

land is a complicated process requiring utilization of the Cost, Income, and Market approaches to value. Each of these approaches is worthwhile and applicable under various circumstances, but a basic tenet of appraisal practice requires as many of them be applied to a specific piece of property as the nature of the property permits. The ultimate valuation is determined by comparing the results of each of these techniques. In order to determine what detail is relevant to support an expert's opinion, it is necessary to briefly examine each of the three valuation methods.

COST APPROACH[14]

The cost approach, which is applicable to improved land, involves estimating the replacement cost of the improvement at present market price, less estimated accrued depreciation, plus estimated land value. This method is particularly useful in valuing special-purpose and service properties such as churches, schools, and libraries which have a limited market and produce no income. The cost approach is also applicable to industrial property that services a stabilized market. The value of newly built income property, which is not yet producing, such as rental projects, is indicated in the cost figures. This approach is limited, however, as it does not reflect economic and marketing conditions.

Four basic methods may be used to determine cost. In each of them the property is broken down into various component units, which may be either the most basic materials in the structure (Qualitative method), larger constructed units (Unit-in-place method), or the number of square feet in the unit (Square-foot Unit-in-place method), or cubic feet (Cubic-foot Unit-in-place method). The cost per component part is computed and the figures are added or multiplied. To this must be added the costs of financing, architects' fees, insurance and permits, taxes, management and other overhead items. The current costs used in determining price per component part can be obtained from local contractors, architects, and engineering firms. But since this is usually expensive and time consuming most appraisers subscribe to various services that furnish comparative cost data.

INCOME APPROACH[15]

The income technique is a mathematical process for converting present and future income derived from the real estate into present

---

[14] *Id.* at 37. See Appendix A.

[15] *Id.* at 54. See Appendix A.

capital value. This approach is applicable to business, industrial, agricultural, and residential property presently earning, or reasonably capable of producing income. Economic demand and existing market conditions are reflected in these figures, which are computed by the direct, indirect, or residual income methods.

*(a) Direct Income Capitalization*

Under the direct income approach, present net income is determined by subtracting from gross income the fixed and variable expenses and losses such as rental vacancy and defaults in collection. The net income figure is then adjusted by the appraiser in view of environmental and inherent factors to arrive at a net income expectancy figure. Environmental factors include trends in economic activity, decentralization of the business area, construction costs, supply and demand of mortgage financing, and supply and demand in the real estate market for the particular type of property. Inherent factors are the remaining economic life of the property and its physical condition.

Next, the capitalization rate, the percentage figure used to convert the expectancy into present dollar value, is applied to the net income expectancy to give a present dollar value to the property. The capitalization rate selected must show a reasonable relationship to the property. The rate is usually selected by using the comparative, component, or synthetic rate methods. The comparative capitalization rate is computed by dividing the sale prices of similar properties into their respective incomes. A component rate is the sum of the current safe rate for investments such as indicated by government bonds, a risk rate which reasonably allows for continued earning ability, a rate reflecting the cost involved in managing the investment, and other factors that happen to be applicable in a particular case. The synthetic rate is based on mortgages suitable for the property and the current market demand for return on equities.

*(b) Indirect Income Capitalization*

The second major income approach is indirect capitalization. It is a simplified method for properties such as single family residences, duplexes, boarding and rooming houses. The actual sale price of similar property is divided by the annual rental income from them. The average of these figures from similar sales is computed to give the gross rent multiplier. The multiplier is taken times the estimated gross rent figure of the subject property to determine the property valuation. This method is accurate because it recognizes the relationship between rental and sale prices.

*(c) Residual Income Method*

A final variation on the income approach, the residual process of capitalization, is used when the value of one of the elements—land or improvements—has been accurately determined. The value of the known element is multiplied by its capitalization rate. This figure is subtracted from total expected net income to indicate the income attributable to the unknown element. This resulting figure is then capitalized to give the present dollar value of the unknown.

MARKET OR COMPARABLE SALES APPROACH[16]

The market approach to value is the third basic valuation method and is used widely in appraising residential and farm lands. It involves the use of sales of comparable properties as indicative of the market price of the subject property. The process generally includes describing and classifying assets, finding sales involving comparable assets, adjusting sale price for differences in time and condition, comparing each sold asset with the subject asset, adjusting for differences and estimating indicated market value of the subject asset in each comparison, and finding the central tendency of the indicated values. Although this method requires many personal judgments in weighing the various similarities and differences in the properties, an outside appraiser not previously familiar with the area market can give an accurate opinion of value. However, to do so requires, at the minimum, that the appraiser refer to data in previous appraisals, interview seller and buyer, consult local real estate agents and brokers, check county records and inspect listings and offers.

From the professional appraiser's point of view an adequate real estate appraisal should include the use of all of these outlined methods, or as many of them as are reasonably applicable. In business, the Cost, Income, and Market approaches to value are used by buyers and sellers to determine the fair market price of property. They constitute the accepted and most reliable methods of valuing real estate. Despite the widespread use of the appraisal process in real estate transactions, the Nebraska courts and most other jurisdictions do not allow the expert witness to testify fully as to his use of the appraisal process.

## OPINION TESTIMONY IN NEBRASKA

In Nebraska, as in other jurisdictions, the question of fair market value is for the jury to determine, relying most heavily on

---

[16] *Id.* at 86.

the opinions of witnesses. The Nebraska Supreme Court has been quite consistent with respect to the requirements for qualification and the use of testimony of opinion witnesses in condemnation cases. The earliest cases took the position that a person who is familiar with the land was qualified to state his opinion of value.[17] This rule was modified to require that the witness also be familiar with the local real estate market.[18] These requirements are easily met since testimony that the witness has resided in the area for a period of time, and the mere statement that he is familiar with the land and market establishes these elements prima facie.[19] The expert, who has not lived in the area, is also allowed to testify if he has familiarized himself with the land and market.[20] There are no distinctions between the opinion testimony of the layman and the expert, since the court holds that the weight of the testimony is for the jury.[21]

When no particular weight is given to the witnesses' testimony, the amount of detail given to support the opinion becomes vitally important. The greatest controversy in Nebraska arose over the use of comparable sales as a basis for opinion. For many years Ne-

---

[17] Wahlgren v. Loup River Pub. Power Dist., 139 Neb. 489, 297 N.W. 833 (1941); Baltimore & M. R.R. v. Schluntz, 14 Neb. 421, 16 N.W. 439 (1883); Republican Valley R.R. v. Arnold, 13 Neb. 485, 14 N.W. 478 (1882) overruling Fremont E.&M.V. R.R. v. Whalen, 11 Neb. 585, 10 N.W. 491 (1881).

[18] O'Neil v. State, 174 Neb. 540, 118 N.W.2d 616 (1962); Medelman v. Stanton-Pilger Drainage Dist., 155 Neb. 518, 52 N.W.2d 328 (1952); Langdon v. Loup River Pub. Power Dist., 142 Neb. 859, 8 N.W.2d 201 (1943), *aff'd on rehearing,* 144 Neb. 325, 13 N.W.2d 168 (1944).

[19] Devore v. Board of Equalization, 144 Neb. 351, 13 N.W.2d 451 (1944); Langdon v. Loup River Pub. Power Dist., 142 Neb. 859, 8 N.W.2d 201 (1943), *aff'd on rehearing,* 144 Neb. 325, 13 N.W.2d 168 (1944); Chicago B. & Q. R.R. v. Shafer, 49 Neb. 25, 68 N.W. 342 (1896); Northeastern Neb. R.R. V. Frazier, 25 Neb. 53, 40 N.W. 609 (1888).

[20] O'Neil v. State, 174 Neb. 540, 118 N.W.2d 616 (1962); Timmonds v. School Dist. of Omaha, 173 Neb. 574, 114 N.W.2d 386 (1962); Devore v. Board of Equalization, 144 Neb. 351, 13 N.W.2d 451 (1944); Langdon v. Loup River Pub. Power Dist., 142 Neb. 859, 8 N.W.2d 201 (1943), *aff'd on rehearing,* 144 Neb. 325, 13 N.W.2d 168 (1944); Beebe & Runyan Furniture Co. v. Board of Equalization, 139 Neb. 158, 296 N.W. 764 (1941).

[21] State v. Wixson, 175 Neb. 431, 122 N.W.2d. 72 (1963); Medelman v. Stanton-Pilger Drainage Dist., 155 Neb. 518, 52 N.W.2d 328 (1952); Langdon v. Loup River Pub. Power Dist., 142 Neb. 859, 8 N.W.2d 201 (1943), *aff'd on rehearing,* 144 Neb. 325, 13 N.W.2d 168 (1944); Wahlgren v. Loup River Pub. Power Dist., 139 Neb. 489, 297 N.W. 833 (1941); Chicago B. & Q. R.R. v. Shafer, 49 Neb. 25, 68 N.W. 342 (1896).

braska followed the New York rule,[22] allowing no direct examination on comparable sales either as supporting detail or substantive evidence, because it would introduce collateral issues.[23] This position was reversed in *Langdon v. Loup River Pub. Power Dist.*,[24] where the court did allow testimony of comparable sales on direct examination, if sufficient foundation was laid to show the similarity between the other land sold and the land in question. Once the similarity of the properties has been shown, evidence of sales is admissible over objections of hearsay evidence.[25] Therefore, both lay and expert witnesses may rely on such sales to form the basis of their opinions.[26] On cross-examination, the witness's qualifications and the detail supporting his opinion may be liberally inquired into for the purpose of discrediting his opinion, but not to introduce substantive evidence as to the value of the land.[27] As this discussion indicates, the Nebraska court has recognized the importance of the Market approach to value.

While it is well settled that comparable sales may be used either as foundation for the witness or as detail testimony, no rules have been set down regulating the minimum amount of knowledge of the land that is necessary.[28] Another question left open by a recent decision is whether the expert may use, as detail, sales not sufficiently similar to be admitted as substantive evidence.[29]

Although the use of testimony of the market approach, or comparable sales, is well established, the same is not true of the other two basic approaches to valuation. There appear to be no decisions regarding the competency of testimony on the cost of replacement.[30]

---

[22] Meehan v. Kaufman, 222 App. Div. 456, 226 N.Y. Supp. 734 (1st Dep't 1928) (holding admission of evidence of similar sales was reversible error).

[23] Swanson v. Board of Equalization, 142 Neb. 506, 6 N.W.2d 777 (1942); Rushart v. State, 142 Neb. 301, 5 N.W.2d 884 (1942), citing authorities.

[24] 142 Neb. 859, 8 N.W.2d 201 (1943), *aff'd on rehearing,* 144 Neb. 325, 13 N.W.2d 168 (1944).

[25] City of Lincoln v. Marshall, 161 Neb. 680, 74 N.W.2d 470 (1956).

[26] Langdon v. Loup River Pub. Power Dist., 144 Neb. 325, 338, 13 N.W.2d 168, 175 (1944).

[27] Johnson v. Airport Authority, 173 Neb. 801, 115 N.W.2d 426 (1962).

[28] Notes 16-20 *supra.* See Appendix B for suggested foundational questions.

[29] O'Neil v. State, 174 Neb. 540, 118 N.W.2d 616 (1962). For cases in other jurisdictions see note 43 *infra.*

[30] *Cf.* Chicago B.&Q. R.R. v. Shafer, 49 Neb. 25, 68 N.W.342 (1896) (where court mentioned, as partial qualification of witness, that he knew value of improvements).

A few decisions do exist on the use of income to determine market value.[31] The general rule appears to be that any evidence relating to income is inadmissible.[32] The ruling is based on the view that income is often attributable to the skill and industry of the owner, and reflects very little about the actual value of the land. Two exceptions to this rule are recognized. First, rental income may be introduced as evidence,[33] because it reflects value of the land and improvements actually attributable to the land itself. The second exception allows evidence of income and profit in determining the value of a leasehold.[34] This is admissible since the consideration paid for the lease often depends on the income-producing ability of the property. Since these two exceptions apply in only a limited number of cases, the value of the land is primarily determined through the use of opinion testimony on comparable sales alone.

---

[31] James Poultry Co. v. City of Nebraska City, 135 Neb. 787, 284 N.W. 273 (1939); Fremont, E. & M.V. R.R. v. Bates, 40 Neb. 381, 58 N.W. 959 (1894); See also, Snyder v. Platte Valley Pub. Power & Irrigation Dist., 144 Neb. 308, 13 N.W.2d 160 (1944).

[32] Papke v. City of Omaha, 152 Neb. 491, 41 N.W.2d 751 (1950); James Poultry Co. v. City of Nebraska City, 135 Neb. 787, 284 N.W. 273 (1939); Snyder v. Platte Valley Pub. Power & Irrigation Dist., 144 Neb. 308, 13 N.W.2d 160 (1944); Fremont, E. & M.V. R.R. v. Bates, 40 Neb. 381, 58 N.W. 959 (1894). *Cf.* State v. Wixson, 175 Neb. 431, 122 N.W.2d 72 (1963), where action of trial court granting new trial on basis of excessive verdict was reversed at 441 the court observed: "The plaintiff argues that an average net income of $3,550, over a period of three years, based upon a valuation of $30,000 and with no amount charged by defendant for wages, is indicative of the fact that the verdict was excessive. The net income of the defendants was slightly in excess of 10 per cent, considered upon a $30,000 valuation. While there is no evidence that defendant took wages out of the business and considered profits over and above the wages, certainly the defendant could run their business as they chose. *In any event, the above matters appear in the record and might have been argued to the jury and considered by the jury.* (Emphasis added.)

[33] Fremont, E & M.V. R.R. v. Bates, 40 Neb. 381, 58 N.W. 959 (1894). The court allowed admission of statement by owner that since the taking he had received less grain rent because the land was less productive. Citing other jurisdictions the court said: "The cases cited all refer to money rent, but we think the principle is the same . . . and applicable to the evidence in reference to rent in the case at bar." *Id.* at 393, 58 N.W. at 963.

[34] James Poultry Co. v. City of Nebraska City, 135 Neb. 787, 284 N.W.273 (1939), allowed no evidence of profits. The decision was modified on rehearing to allow evidence of past profits as tending to show the value of the leasehold, 136 Neb. 456, 286 N.W. 337 (1939).

## OPINION TESTIMONY IN OTHER JURISDICTIONS

To qualify as an opinion witness in other states, the witness must show that he has means for forming his opinion beyond that held by men generally, or that he is sufficiently well informed to be helpful to the jury.[35] These requirements are met, as in Nebraska, by proving that the witness is familiar with the property in question and the market.[36] Both real estate experts and laymen may qualify to testify to the value of the land whether it be rural or urban.[37] Some courts hold the view that laymen are perhaps more qualified to testify to the value of farm land in their own community than the most competent outsider.[38] In respect to urban land the courts allow a presumption that land owners in the area are qualified to testify.[39] The courts are divided on whether any witness, lay or expert, may rely on hearsay knowledge in foundational matters.[40]

It is important to keep in mind the differences between the requirements for qualifying the witness, and the rules regarding detail of testimony to support the opinion. In other jurisdictions, as in Nebraska, the greatest controversy over detail relates to the use of comparable sales. Only one court still follows the old New York rule that no evidence of comparable sale is allowed on direct

---

[35] United States v. 13,255.53 Acres of Land, 158 F.2d 874 (3d Cir. 1946); Welch v. TVA, 108 F.2d 95 (6th Cir. 1939); Trunkline Gas Co. v. O'Bryon, 21 Ill. 2d 95, 171 N.E.2d 45 (1960).

[36] Montana Ry. v. Warren, 137 U.S. 348 (1890); United States v. Nickerson, 2 F.2d 502 (1st Cir. 1924); Board of Park Comm'rs v. Fitch, 184 Kan. 508, 337 P.2d 1034 (1959); Massie v. City of Floydada, 112 S.W.2d 243 (Tex. Civ. App. 1938).

[37] H.&H. Supply Co. v. United States, 194 F.2d 553 (10th Cir. 1952); Welch v. TVA, 108 F.2d 95 (6th Cir. 1939); Shelby County v. Baker, 269 Ala. 111, 110 So. 2d 896 (1959); Mitchell v. Texas Elec. Serv. Co., 299 S.W.2d 183 (Tex. Civ. App. 1957); Stevenson v. East Deer Township, 379 Pa. 103, 108 A.2d 815 (1954).

[38] Montana Ry. v. Warren, 137 U.S. 348 (1890); Welch v. TVA, 108 F.2d 95 (6th Cir. 1939); Board of Park Comm'rs v. Fitch, 184 Kan. 508, 337 P.2d 1034 (1959); Baker Metropolitan Water & Sanitation Dist. v. Baca, 138 Colo. 239, 331 P.2d 511 (1958).

[39] Brown v. Town of Eustes, 293 Fed. 197 (S.D. Fla. 1923); Board of Park Comm'rs v. Fitch, 184 Kan. 508, 337 P.2d 1034 (1959); People v. Willis, 30 Cal. App. 2d 419, 86 P.2d 670 (Dist. Ct. App. 1939).

[40] United States v. 5139.5 Acres of Land, 200 F.2d 659 (4th Cir. 1952); City of Denver v. Quick, 108 Colo. 111, 113 P.2d 999 (1941); Redfield v. Iowa State Highway Comm'n, 251 Iowa 332, 99 N.W.2d 413 (1959); Stewart v. Commonwealth, 337 S.W.2d 880 (Ky. App. 1960).

examination.[41] At the least, all other courts allow experts to testify to comparable sales, and many allow such testimony by laymen.[42] One question on which there is very little case law, and which may become an important area of controversy, is whether experts may rely on comparable sales as supporting evidence if the sales have been ruled inadmissible as substantive evidence.[43]

There is no consistent pattern in the decisions as to what distinctions will or will not be drawn in a particular jurisdiction. For example, the Kentucky court[44] has held that evidence of comparable sales was competent and probative. The evidence could not be based on hearsay, however, unless the witness was an expert, in which case it could be used either as qualifying foundation or as detail basis for his opinion. In contrast, Iowa[45] held that comparable sales could be used as supporting or substantive evidence by experts on direct examination. With respect to laymen, however, sales could be used only to test their competency on cross-examination.

A number of jurisdictions have recognized the importance of the cost approach to value, although it is not supported by as large a body of law as the market approach.[46] The courts are divided on

---

[41] Luecke v. State Highway Comm'n, 186 Kan. 584, 352 P.2d 454 (1960). For cases adopting majority view see County of Los Angeles v. Faus, 48 Cal. 2d 672, 312 P.2d 680 (1957); Redfield v. Iowa State Highway Comm'n, 251 Iowa 332, 99 N.W.2d 413 (1959); *In re* Civic Center, 335 Mich. 528, 56 N.W.2d 375 (1953). For compilation of cases on comparable sales see Annot., 85 A.L.R.2d 110 (1962).

[42] 5 NICHOLS, EMINENT DOMAIN § 21.3 (3d ed. 1962).

[43] United States v. Certain Interests in Property, 186 F. Supp. 167 (N.D. Calif. 1960); People v. Gangi Corp., 15 Cal. Rep. 19 (Dist. Ct. App. 1961), *rev'd*, 57 Cal. 2d 346, 19 Cal. Rptr. 473, 369 P.2d 346 (1962).

[44] Stewart v. Commonwealth, 337 S.W.2d 880 (Ky. App. 1960). See also Commonwealth v. Citizen's Ice & Fuel Co., 365 S.W.2d 113 (Ky. App. 1963).

[45] Redfield v. Iowa State Highway Comm'n, 251 Iowa 332, 99 N.W.2d 413 (1959). Compare Langdon v. Loup River Pub. Power Dist., 142 Neb. 859, 8 N.W.2d 201 (1943), *aff'd on rehearing*, 144 Neb. 325, 13 N.W.2d 168 (1944), which allowed laymen and experts to testify to sales either as supporting or substantive evidence, even if gained from hearsay source.

[46] Hanson Co. v. United States, 261 U.S. 581 (1923); Stevenson Brick Co. v. United States *ex rel.* TVA, 110 F.2d 360 (5th Cir. 1940); County of Cook v. Colonial Oil Corp., 15 Ill. 2d 67, 153 N.E.2d 844 (1958); State v. Red Wing Laundry & Dry Cleaning Co., 253 Minn. 570, 93 N.W.2d 206 (1958).

whether cost data is admissible in all instances,[47] or only when no evidence of comparable sales is available.[48] Standing alone, valuation based on cost tends to be misleading since the figures reflected are inflationary in nature. Therefore, cost figures are considered to set the highest limit of value for the property and a condemnation award should never exceed them.[49] Such figures are important, however, since they reflect differences in improvements that can be only estimated by the market approach.

Both federal and state courts have specifically held that loss of business profits is not compensable in condemnation proceedings,[50] because the business itself has not been taken and it may be moved elsewhere. Evidence of business profits, as tending to show the value of the land, is inadmissible since the profits are attributable more to the industry, skill, and personality of the owner. In addition they are too uncertain to form a basis for compensation. Several major exceptions have been made in cases where the income is clearly attributable to the land rather than the owner. In many states either the productivity of the business,[51] or the income from farm crops[52] is admissible as tending to show the value of the land, but not as separate items of damage. The value of peculiar enter-

---

[47] State v. Red Wing Laundry & Dry Cleaning Co., 253 Minn. 570, 93 N.W.2d 206 (1958).

[48] United States v. Benning Housing Corp., 276 F.2d 248 (5th Cir. 1960).

[49] *Ibid.*

[50] Backus v. Fort St. Union Depot Co., 169 U.S. 557 (1898); United States v. Meyer, 113 F.2d 387 (7th Cir. 1940); Wilson v. Iowa State Highway Comm'n, 249 Iowa 994, 90 N.W.2d 161 (1958); Amory v. Commonwealth, 321 Mass. 240, 72 N.E.2d 549 (1947). A leading case in the area, Gauley & E. Ry. v. Conley, 84 W. Va. 489, 494, 100 S.E. 290, 292 (1919) stated: "The true reason may be that presumptively the world affords the trader just as good opportunities in other places, and the inconvenience and expense of finding another location are incidents of the business, and not elements of damage to the property condemned . . . ." See discussion in 22 MONT. L. REV. 80 (1960).

[51] St. Louis Housing Authority v. Bainter, 297 S.W.2d 529 (Mo. 1957); City of Denver v. Quick, 108 Colo. 111, 113 P.2d 999 (1941).

[52] Cases on admission of evidence of rents and profits are collected in 65 A.L.R. 455 (1930). Cases on admission of evidence of income from farm products are collected in 16 A.L.R.2d 1113 (1951). Compare Korf v. Fleming, 239 Iowa 501, 32 N.W.2d 85 (1948) (allowing evidence of present and past crop values as tending to show value of leasehold), with Wilson v. Iowa State Highway Comm'n, 249 Iowa 994, 90 N.W.2d 161 (1958) (holding farm owner's statement of net monthly income inadmissible).

prises such as franchises for toll roads may be based entirely on income figures.[53]

Perhaps the most important exception to the rule excluding income evidence is the admissibility of rental income.[54] The courts consider that the rent paid actually reflects the quality, suitability, adaptablity, and location of the land. Rental income, by itself, may be admissible,[55] or it may be capitalized[56] as tending to show the value of the land. While the vast majority of cases allowing evidence of rental income are based on actual rental figures for the land, Texas[57] has allowed hypothetical inference of rental value to stand as evidence of land value when there was a partial taking from the owner. Under such a practice, if reasonably accurate rental value before and after taking can be determined, it will reflect the injury to the land in income figures, without compensating for lost profits.

## EXPANDING THE SCOPE OF EXPERT TESTIMONY

In Nebraska, where testimony is limited to comparable sales and occasionally rental value or past profits in leaseholds, the use

---

[53] Chestnut Hill & Spring House Turnpike Rd. Co. v. Montgomery County, 228 Pa. 1, 76 Atl. 726 (1910).

[54] United States v. General Motors Corp., 323 U.S. 373 (1945); Demetria Sifuentes v. United States, 168 F.2d 264 (1st Cir. 1948); State v. Crockett, 134 So. 2d 341 (La. Ct. App. 1961); Bergeman v. State Rds. Comm'n of Maryland, 218 Md. 137, 146 A.2d 48 (1958).

[55] United States v. General Motors Corp., 323 U.S. 373 (1945); Spitzer v. Slickman, 278 F.2d 402 (2d Cir. 1960); Lebanon & Nashville Turnpike Co. v. Creveling, 159 Tenn. 147, 17 S.W.2d 22 (1929).

[56] State v. Clarke, 135 So. 2d 329 (La. App. 1961); State v. Crockett, 134 So. 2d 341 (La. Ct. App. 1961); Burritt Mut. Sav. Bank v. City of New Britain, 20 Conn. Supp. 476, 140 A.2d 324 (C.P. 1958); Winepol v. State Rds. Comm'n of Maryland, 151 A.2d 723, 725 (Md. Ct. App. 1959): "[C]apitalization of the income which a property will produce is relevant and pertinent evidence of its value to a willing purchaser . . . ."

[57] City of Dallas v. Priolo, 150 Tex. 423, 242 S.W.2d 176 (1951). *Cf.* Herdon v. Housing Authority, 261 S.W.2d 221 (Tex. Civ. App. 1953); State v. Parkey, 295 S.W.2d 457 (Tex. Civ. App. 1956) (limiting use of rental income to cases of partial taking). Compare State v. Peterson, 134 Mont. 52, 328 P.2d 617 (1958) (where court allowed evidence of net profits of business located near highway). Criticised in 22 MONT. L. REV. 80 (1960). See also, Note, 66 DICK L. REV. 453, 465 (1962), suggesting that the profit and loss statement of a business is always considered by a willing buyer.

of the expert is severely restricted. Relying on the premise that accurate real estate valuation requires consideration of as many of the three elements of value as are applicable, it is obvious that the present rules of evidence are too narrowly drawn and that important areas of economic influence are ignored.

It is true the expert may testify to the effect of comparable sales on the value of the land in question, but so may any layman residing in the area. Any special credence given to the expert must come from his own reputation and his ability to detail his analysis. If admissible detail is limited to comparable sales, an expert using the proper valuation techniques may have unexplainable discrepancies in his analysis which can be used to discredit him on cross-examination. In addition, cases may arise where no sufficient evidence of comparable sales is available.[58]

It is certainly not contended that appraisal of value is an exact science. But the expert, through study and detailed analysis of the real estate market possesses a special skill that enables him to draw reasonable conclusions from the data he has compiled. The psychiatrist, sociologist, criminologist, and members of the physical sciences are allowed to rely on experience and discipline in their fields. They are allowed to rely on hearsay evidence and to detail important considerations used by them in drawing conclusions because such evidence can aid the jury in reaching accurate determinations of fact. The value expert should be given similar latitude in testimony in order to aid the jury.[59]

Evidence of reproduction costs tend to be misleading because of its inflationary nature, but with proper instructions to the jury

---

[58] United States v. Benning Housing Corp., 276 F.2d 248 (5th Cir. 1960), where condemned property was privately owned and governmently regulated Wherry rental housing project. For interesting examination of Wherry Housing condemnation including capitalization of controlled rents, reproduction costs, and the possible existence of a national real estate market see Likins-Foster Monterey Corp. v. United States, 308 F.2d 595 (9th Cir. 1962); Fairfield Gardens, Inc. v. United States, 306 F.2d 167 (9th Cir. 1962).

[59] State v. Arnold, 218 Ore. 43, 341 P.2d 1089, 1102 (1959): "A perusal of the journals published by the appraisal profession makes it clear that the qualified members of that profession must have a rather extensive and technical knowledge in their field. It is not unlike the type of special knowledge which elevates other recognized specialists into the class of experts." See also, Denver Joint Stock Land Bank v. Board of County Comm'rs, 105 Colo. 366, 98 P.2d 283 (1940) (holding appraiser was within statute regulating expert witness fees and overruling previous decision).

there is no reason why a man qualified to draw conclusions from the figures should not be allowed to do so. This is true not only in cases where no evidence of comparable sales exists, but in any proceeding where the economic effect on the land is important. In particular cases improvements may add nothing to the value of the land. If, for example, the improvement is in a deplorable condition, or a reasonable use for the structure no longer exists, consideration of replacement cost would be unwarranted.[60]

In Nebraska the value of land is to be determined by considering all possible uses.[61] Taken literally, this would necessitate considering its use as an income producing property. It is unreasonable to allow evidence of rental value being paid and to consider this effect on the value of the land as a whole and then ignore any income effect on land not being presently rented, for all possible uses are not being considered. The same is true of rules allowing evidence of past profits to show the value of a leasehold, but not a freehold. In market transactions, the willing buyer and seller take income into consideration in either case. Rules on admissibility of evidence should be expanded to allow use of the income approach commensurate with the effect of income on market price.

Furthermore, rental and past profit figures are not presently capitalized in Nebraska.[62] They stand as naked figures from which it is difficult to draw conclusions as to the effect on value. Use of capitalization rates would allow the expert to reasonably explain income effect, and would allow opposing counsel and the jury to examine the accuracy of the conclusions.

---

[60] *In re* City of New York, 198 N.Y. 84, 86-87, 91 N.E. 278, 278-79 (1910): "In some cases the value of expensive structures may not enhance the value of the land at all. An extremely valuable piece of land may have upon it cheap structures which are a detriment rather than an improvement. A man may build an expensive mansion upon a barren waste, and, in such a case, the costly building may add little or nothing to the total value. In the greater number of cases, however, the value of the buildings does enhance the value of the land. . . . It must follow that such differences contribute in varying degrees to the enhancement in the value of the land, and we can think of no way in which they can be legally proved except by resort to testimony of structural value, which is but another name for cost of reproduction, after making proper deductions for wear and tear."

[61] O'Neill v. State, 174 Neb. 540, 118 N.W.2d 616 (1962); Lynn v. City of Omaha, 153 Neb. 193, 43 N.W.2d 527 (1950).

[62] James Poultry Co. v. City of Nebraska City, 136 Neb. 456, 286 N.W. 337 (1939); Fremont, E. & M.V. R.R. v. Bates, 40 Neb. 381, 58 N.W. 959 (1894).

Expansion of rules on admissibility of evidence by allowing reproduction cost and capitalized income figures would certainly present some trial difficulties. The question of the relevancy of any particular fact must be ruled on by the court, weaknesses in analysis must be ferreted out by the opposing counsel, and the ultimate determination of the weight of the evidence must be made by the jury. Collateral issues would be raised as to the proper cost indexes and depreciation formulas to apply in fixing replacement cost, the amount of income attributable to the land, and the reasonableness of the capitalization rate.

Collateral issues are also raised at the present time by allowing evidence of comparable sales, but the courts have allowed the evidence, nonetheless, because experience shows that comparable sale prices are important in determining value.[63] However, experience in real estate transacions has also shown that evidence limited to comparable sales is complete and accurate only when the properties are identical. The difference of price between two properties depends on their incomparable features, the quality and usefulness of the improvements, and the advantages of location and adaptability for various income producing projects. These incomparable features can be adequately considered by expanding the rules of evidence despite the accompanying difficulties.[64]

No exact formula can be set down for determining the procedure to be followed in admitting evidence of income and replacement cost. For example, income figures for leaseholds may be computed on the basis of actual payment by the lessee, or past or anticipated profits. Rental income might be determined on the basis of actual rent payment or on the basis of an average value computed from similar properties. Income producing property actually rented may be viewed in the light of comparable rental properties, or on the basis of the percentage of anticipated income that the investor would be willing to pay for rental of the property. All of these methods require the use of more or less speculative

---

[63] Langdon v. Loup River Pub. Power Dist., 142 Neb. 859, 8 N.W.2d 201 (1943).

[64] In City of La Grange v. Pieratt, 142 Tex. 23, 28, 175 S.W.2d 243, 246 (1943), the court stated: "Profits which would have been earned by an established business, absent any interference therewith, are in their very nature more or less conjectural, uncertain, and speculative, but this does not deprive the party injured by such interference of his right to recover. In other words, the difficulties which may lie in the way of making proof will not defeat a recovery."

figures, but the market itself operates on these figures. The success of our economy can be partly attributed to the accuracy that does exist in the use of the appraisal process in business transactions.

## CONCLUSION

Whether the expert is considered a person whose testimony is to be viewed with suspicion, or as a skilled witness who is able to appreciably aid the jury, allowing the witness to detail his analysis by testifying to replacement cost or capitalized income will be advantageous. Opposing counsel may extensively cross-examine to expose carelessly or fallaciously employed techniques and figures, and the jury can fully view the basis for the witness's opinion and not be restricted to the present fragmentary account. No comparative advantage for either the condemnor or condemnee would result, for the valuations would not be uniformly higher or lower. The result would be a more accurate land valuation process. No serious obstacle to implementing the changes suggested would be caused by stare decisis, for the modifications would affect only trial procedure in which there is no problem of detrimental reliance on prior decisions. Recognition of existing appraisal processes by the courts, and the admission of more evidence to support the opinion of the expert will work to the disadvantage of no party, but will assist in seeing that the condemnee does receive just compensation.

*Richard P. Nelson '64*

## APPENDIX A

### REAL ESTATE APPRAISAL FORMULAS

COMPUTATION USING COST APPROACH

1. Unit cost × No. of units = Base Cost
2. Base cost + Financing + Architect's fees + Overhead = Actual cost of improvement
3. Actual cost — Accrued depreciation + Land value = TOTAL EVALUATION

COMPUTATION USING INCOME APPROACH

1. *Direct Income Capitalization*
   A. Gross income — Expenses and losses = Net income
   B. Net income + (−) Environmental and inherent factors = NET INCOME EXPECTANCY
   C. Capitalization rate
      (1) $\frac{\text{Current income of similar property}}{\text{Sale price of similar property}}$
      or
      (2) Safe rate of investment + Risk rate + Management cost rate
      or
      (3) Current return on applicable mortgage financing
   D. $\frac{\text{Net income expectancy}}{\text{Capitalization rate}} \times 100 = \text{TOTAL EVALUATION}$
2. *Indirect Income Capitalization*
   A. $\frac{\text{Sale price of similar properties}}{\text{Rental incomes of sale properties}} = \text{Gross rent multiplier}$
   B. Gross rent multiplier × Rental income of subject property = TOTAL EVALUATION
3. *Residual Income Method of Capitalization*
   A. Net income expectancy — (Value of known element × capitalization rate) = Income attributable to unknown
   B. $\frac{\text{Income attributable to unknown}}{\text{Capitalization rate}} \times 100 = \text{Value of unknown}$
   C. Value of unknown + Value of known = TOTAL EVALUATION.

## APPENDIX B

### FOUNDATION FOR INTRODUCTION OF COMPARABLE SALES

The present rules in Nebraska prescribe no particular knowledge that is necessary to qualify a witness to testify to the value of the land in question and to compare it with similar sales. The following questions are suggested as covering the minimum amount of knowledge that any witness should have before the jury is allowed to consider his testimony.*

1. Have you in your appraisal of the_____property considered sales of other property and compared these properties to the _____property?
2. Would you state the sale that you have considered, giving the name of the Seller and the name of the Buyer?
3. Would you state the date this property was sold?[1]
4. What is the location of this property with reference to the _____property?
5. Would you describe this property and compare it to the _____property?
6. Describe this property and compare it with the_____property including comparison of buildings, if any, land quality. etc.[2]

---

* Compiled by E. E. Christensen, Chief Attorney, Right of Way Division, Department of Roads, State of Nebraska. (Citations added.)

[1] The date of sale is important in determining whether the sales are sufficiently contemporary to afford a basis for comparison. See Timmonds v. School Dist., 173 Neb. 574, 114 N.W.2d 386 (1962); Papke v. City of Omaha, 152 Neb. 491, 41 N.W.2d 751 (1950); City of Lincoln v. Marshall, 161 Neb. 680, 74 N.W.2d 470 (1956).

[2] Property must be shown to be sufficiently similar to afford a basis of comparison. Admission of the evidence is within the discretion of the trial judge. Redfield v. Iowa State Highway Comm'n, 251 Iowa 332, 341, 99 N.W.2d 413, 418 (1959): " 'Similar does not mean identical, but having a resemblance; and property may be similar in the sense in which the word is here used though each possesses various points of difference.' Forest Preserve Dist. v. Lehmann Estate, Inc., 388 Ill. 416, 428, 58 N.E.2d 538, 544. Size, use, location and character of the land, time, mode and nature of the sale all have a bearing on the admissibility of such evidence."
See O'Neill v. State, 174 Neb. 540, 118 N.W.2d 616 (1962); Langdon v. Loup River Pub. Power Dist., 142 Neb. 859, 8 N.W.2d 201 (1943), *aff'd on rehearing*, 144 Neb. 325, 13 N.W.2d 168 (1944).

7. Did you investigate the terms of this transaction and talk to the Buyer, Seller or Real Estate Agent involved?
8. Did your investigation reveal this transaction to be an open market transaction, in other words between a willing purchaser and a willing seller?[3]
9. Did you consider and did you find whether the property was purchased for a specific purpose?[4]
10. What was the sale price?

## ADDITIONAL POINTS OF INQUIRY

1. Describe the transaction, whether or not it was a contract for deed, a cash sale, assumption of mortgage, amount paid down.
2. Did you examine the instrument of sale?
3. Was this property under lease or of particular advantage to either of the parties?
4. Was the sale price enhanced by reason of the anticipated acquisition by the Department of Roads of other land?[5]
5. What was the zoning?[6]
6. Did you check the deed record and verify that this was a bona fide transaction?

---

[3] To be admissible a sale cannot have been made under unusual circumstances that would inflate or deflate prices. Lynn v. City of Omaha, 153 Neb. 193, 195-96, 43 N.W.2d 527, 529 (1950): "Individual sales throw no light on market values if in any sense compulsory . . . ."; Papke v. City of Omaha, 152 Neb. 491, 41 N.W.2d 751 (1950).

[4] Langdon v. Loup River Pub. Power Dist., 142 Neb. 859, 865, 8 N.W.2d 201, 204 (1943): "To demonstrate nonadmissibility under the rule, let us say the other lands were purchased for a specific purpose such as a filling station or some other commercial enterprise not common to the particular location, and for that reason the purchaser was willing to pay much more than market or going value."

[5] Note 3 *supra.*

[6] O'Neill v. State, 174 Neb. 540, 118 N.W.2d 616 (1962) (where expert was allowed to consider effect of zoning on value).